

Message Text

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INFO OCT-01 EA-07 IO-11 ISO-00 SP-02 AID-05 EB-07 NSC-05

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TO SECSTATE WASHDC 8514

INFO AMEMBASSY BERN

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: ECON, EFIN, UK

SUBJECT: THE ANTI-INFLATION PROGRAM REACHES A MAJOR
HURDLE

REF: LONDON 1325

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1 THE BRITISH ECONOMY IS CURRENTLY PASSING THROUGH WHAT

CAN BE BEST DESCRIBED AS THE "COLD TURKEY" PHASE OF A CYCLE WHICH HAS BROUGHT THE MOST SEVERE SUSTAINED INFLATION SINCE THE WAR. THE PRESENT REACTION TO RISING UNEMPLOYMENT IS THE KIND OF CONVULSION THAT ACCOMPANIES A DECISION TO END THE WAGE SPIRAL LARGELY RESPONSIBLE FOR UNLEASHING THE INFLATION SURGE. INDEED, THE PRIME MINISTER HIMSELF WARNED OF THE LONG HARD WINTER AND THE NEED TO ACCEPT "ROUGH JUSTICE" WHEN HE ANNOUNCED THE GOVERNMENT'S ANTI-INFLATION PROGRAM LAST SUMMER. THIS WARNING AROUSED LITTLE PROTEST AT THE TIME. THE UNION LEADERSHIP HAD BEGUN TO CLOSE RANKS BEHIND THE GOVERNMENT AND THEIR RANK AND FILE WERE STILL FLUSH WITH SPRING WAGE SETTLEMENTS AVERAGING 30 PERCENT. SIX MONTHS LATER WITH UNEMPLOYMENT 50 PERCENT HIGHER AND INFLATION HAVING SERIOUSLY ERODED THE GAINS IN REAL INCOMES OF LAST SPRING, IT WAS CLEAR THAT RUMBLINGS AGAINST PERCEIVED GOVERNMENT CALLOUSNESS OVER THE RISING JOBLESS TOTALS WOULD GROW LOUDER.

2. THE IRONY OF THIS SITUATION IS NOT LOST ON MEN LIKE DENIS HEALEY AND HAROLD WILSON. JUST WHEN THEIR POLICY

IS BEGINNING TO BEAR FRUIT, ELEMENTS OF THOSE GROUPS (SUCH AS THE TUC AND PLP - SEE REFTEL) ON WHOM THEY MUST DEPEND SHOW SIGNS OF WAVERING IN THEIR RESOLVE WITH SOME EVEN CALLING FOR MEASURES THAT COULD DESTROY THE STILL FRAGILE CLIMATE OF COOPERATION THAT HAS MADE POSSIBLE THE MARKED IMPROVEMENT IN PRICES OVER THE PAST 6 MONTHS.

3. THE IMMEDIATE ISSUE CONCERNS THE GOVERNMENT'S FORTITUDE IN THE FACE OF A WAVE OF DEMANDS FOR QUICK ACTION TO REDUCE THE RANKS OF THE UNEMPLOYED. IN THEIR PUBLIC STATEMENTS, CABINET MEMBERS WITH DIRECT RESPONSIBILITY FOR SOME ASPECT OF THE ECONOMY HAVE ECHOED HAROLD WILSON'S DETERMINATION TO SEE THE CURRENT POLICY THROUGH IN POLITICAL TERMS, THIS DETERMINATION WILL REQUIRE EVERY PLOY IN THE PRIME MINISTER'S SEEMINGLY BOUNDLESS REPERTOIRE. IN ECONOMIC TERMS, THE SCOPE FOR MANEUVER IS PAINFULLY NARROW.

4. IN A SENSE, THE GAME BOARD FACING THE PLAYERS HAS NOT LIMITED OFFICIAL USE

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CHANGED MUCH SINCE MID-DECEMBER WHEN THE CHANCELLOR ANNOUNCED HIS LAST PACKAGE OF MEASURES, INCLUDING LIMITED IMPORT CONTROLS, TO EASE THE IMPACT OF UNEMPLOYMENT ON THOSE GROUPS MOST SERIOUSLY AFFECTED. HIS POSITION IS MORE DIFFICULT NOW SINCE THOSE AND OTHER PREVIOUS MEASURES HAVE BEEN PROVED RELATIVELY INEFFECTUAL. WITH THE GOVERNMENT HAVING PROMISED TO RESPOND IN SOME WAY TO THOSE DEMANDING FURTHER ACTION, THE CHANCELLOR IS UNDER

SEVERE PRESSURE TO PRODUCE YET ANOTHER PACKAGE; THIS TIME ONE WITH TEETH. HE CANNOT SUBMIT TO THIS PRESSURE WITHOUT JEOPARDIZING THE SHAPE OF THE NEXT BUDGET DUE BY APRIL, THE SECOND PHASE OF THE INCOMES POLICY WHICH WILL BE SERIOUSLY NEGOTIATED BETWEEN APRIL AND JUNE, AND THE CONFIDENCE OF AN INTERNATIONAL FINANCIAL COMMUNITY WHICH IS JUST STARTING TO ACCEPT THE FACT THAT BRITAIN IS GRAPPLING REALISTICALLY WITH ITS ECONOMIC DIFFICULTIES. IT FOLLOWS THAT WHATEVER NEW ACTION MAY BE ANNOUNCED OVER THE NEXT 10 DAYS OR SO, WHILE PACKAGED TO GIVE THE IMPRESSION THAT THE GOVERNMENT HAS INDEED RESPONDED TO THE SITUATION, CAN DO LITTLE MORE THAN BUY TIME UNTIL THE BUDGET IS ANNOUNCED.

5. IT IS REMARKABLE THAT THE GOVERNMENT HAS BEEN ABLE TO NEGOTIATE SO SMOOTHLY THE POTENTIAL HAZARDS THAT STOOD IN

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THE PATH OF THE SIX-POUND WAGE LIMITATION. THE GOVERNMENT WAS PREPARED TO SEE THE UNEMPLOYMENT RATE RISE IN THE INTEREST OF CUTTING INFLATION. HOWEVER, THE PACE AND VARIABILITY OF THAT RISE WAS MORE THAN COULD HAVE BEEN ANTICIPATED. AS A RESULT, JOBLESS FIGURES (BEFORE ADJUST-
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MENT FOR SEASONAL AND OTHER FACTORS) REACHED A LEVEL IN JANUARY THAT SEEMED MORE PROBABLE IN MARCH OR APRIL. HAD THE FIGURES RISEN MORE SLOWLY, CRIES OF ALARM SET OFF WHEN THE JOBLESS TOTAL CROSSED 1.4 MILLION COULD HAVE BEEN CHECKED BY MEASURES IN AN APRIL BUDGET. WITH HIS TIMING DISTURBED, THE CHANCELLOR MAY BE FORCED TO MOVE MORE QUICKLY THAN PLANNED, ALTHOUGH HE SHOULD PREVAIL OVER ANY SERIOUS THREATS TO THE PRESENT POLICY. THERE ARE SEVERAL REASONS FOR THIS. WHILE THE UNDERLYING TREND WILL CONTINUE RISE, THE FEBRUARY JOBLESS FIGURES SHOULD SHOW A DECLINE IN THE UNADJUSTED TOTAL AS STUDENTS RETURN TO CLASSES FOR THE SPRING SEMESTER. OTHER INDICATORS INCLUDING INDUSTRIAL PRODUCTION, WHOLESALE AND RETAIL PRICES SHOULD CONTINUE TO SHOW IMPROVEMENT. THE IMPLEMENTATION OF THE LONG-AWAITED SCHEME TO HOLD RETAIL PRICE INCREASES ON CERTAIN BASIC CONSUMER GOODS TO 5 PERCENT BETWEEN FEBRUARY AND JULY IS IMMINENT AND WILL BE SOLD AS FURTHER EVIDENCE OF THE GOVERNMENT'S CONCERN TO HELP THE AVERAGE CONSUMER.

6. WHILE THERE CAN BE NO DOUBT ABOUT THE GENUINENESS OF THE REACTION THE LEADERSHIP OF INDIVIDUAL UNIONS, THE TUC OR THE PARLIAMENTARY LABOR PARTY TO THE INDIVIDUAL AND COMMUNITY SUFFERING INHERENT WITH WELL OVER 1.4 MILLION JOBLESS, THERE IS PRECIOUS LITTLE EVIDENCE THAT THIS EPISODE WILL TURN OUT AS MORE THAN A SERIOUS SPASM WHICH CAUSES SOME CHANGE IN GOVERNMENT TACTICS AND TIMING.

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